

RECEIVED **COMMISSIONERS** 1 , 2014 MAY 16 P 3: 39 BOB STUMP, Chairman 2 **GARY PIERCE BRENDA BURNS** 3 ORIGINAL **BOB BURNS** 4 SUSAN BITTER SMITH 5 BEFORE THE ARIZONA CORPORATION COMMISSION 6 7 In the matter of: Docket No. S-20906A-14-0063 CONCORDIA FINANCING COMPANY, 9 (Assigned to the Honorable Mark LTD, 10 Preny, Administrative Law Judge) a/k/a "CONCORDIA FINANCE," 11 ER FINANCIAL & ADVISORY SERVICES. Oral Argument: May 21, 2014 (10 a.m) 12 LLC, 13 LANCE MICHAEL BERSCH, and Arizona Corporation Commission 14 DOCKETED DAVID JOHN WANZEK and LINDA 15 WANZEK, husband and wife, MAY 16 2014 Respondents. 16 DOCKETED BY 17 18 19 REPLY IN SUPPORT OF 20 **MOTION TO DISMISS** 21 by 22

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Respondents ER Financial & Advisory Services, LLC, Lance Michael Bersch, David John Wanzek, and Linda Wanzek

ROSHKA DEWULF & PATTEN, PLC ONE ARIZONA CENTER 400 EAST VAN BUREN STREET - SUITE 800 PHOENIX, ARIZONA 85004 TELEPHONE NO 602-256-6100 FACSIMILE 602-256-6800

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I. Introduction.

The Division's Notice¹ should be dismissed because:

- 1. The claims asserted by the Division are very stale, relating to transactions made up to 20 years ago. The Division does not dispute that the vast majority of transactions occurred long ago. It is not fair to pursue such superannuated claims; they should be dismissed under the statute of limitations, due process or latches.
- 2. The Truck Servicing Agreements are not securities. As explained in the motion, the contracts are not securities because there is no "common enterprise" and there is no "expectation of profit" through the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293, 300 (1946). The Division fails to offer any Howey analysis. The Division simply claims that there are disputed fact issues, but it does not offer any analysis of how its facts meet the Howey standard, and the mere allegation that the contracts are securities is a legal conclusion that is owed no deference.
- 3. The Notice does not provide a clear statement of the charge against the Respondents. As to the fraud claims, while the Division scoffs at the suggestion that it has to follow Rule 9(b) like everyone else, that rule is incorporated into the Commission's rules of practice and procedure and applies as the most specific rule on point.
- 4. Lastly, despite a clear showing that Mrs. Wanzek is a non-Arizona spouse, the Division refuses to dismiss her from this case. Further, the Division cites no authority for the proposition that it can proceed against a non-existent marital community.

II. The "violations" alleged in the Notice are far too old to pursue.

A. Statutes of limitations protect citizens from the government.

As the Supreme Court recently explained in a SEC case, the statute of limitations provides vital protections to citizens:

¹ Capitalized terms not defined herein have the meanings given them in the Motion to Dismiss.

- it "would be utterly repugnant to the genius of our laws" if enforcement actions could "be brought at any distance of time."
- Statutes of limitations "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared."
- They provide "security and stability to human affairs."
- They are "vital to the welfare of society,"

Gabelli v. SEC, 133 S.Ct. 1216, 1221, 1223 (2013). The Division suggests statutes of limitations should apply to claims by common citizens, but not government agencies. The Supreme Court firmly rejected this line of thinking in Gabelli.

In response to the argument that "There is no reason that the [Commission] should be able to tread where the S.E.C. cannot", the Division vaguely refers to "federalism". While the ER Respondents share the Division's appreciation for the virtues of federalism, the Arizona Supreme Court has, as a matter of state law, determined that Arizona should follow federal securities law. See e.g. Sell v. Gama, 231 Ariz. 323, 327, 295 P.3d 421, 425 (2013)("we will interpret the ASA by following settled federal securities law unless there is a good reason to depart from that authority"). Under settled federal law, the SEC could not bring such a case because it is simply too old. If the Division's view were correct, Arizona's law would be far more liberal than federal law. Under Sell, that is not the case.

B. Trimble does not control.

The Division has gone so far as to threaten sanctions against undersigned counsel for daring to raise the statute of limitations issue. (See Exhibit 1). In its sanctions letter, the Division argued that undersigned counsel committed misconduct by failing to cite the supposedly "controlling" case of *Trimble v. Am. Sav. Life Ins. Co.*, 152 Ariz. 548, 554, 733 P.2d 1131, 1137 (Ct. App. 1986). We stand by our motion, and do not believe that *Trimble* is controlling, as explained in detail in our letter to the Division on April 9, 2014. (Exhibit

² Division Response at 8:5-7.

<u>2</u>). Our letter explained that *Trimble* is not controlling for five reasons. We incorporate these five points into this reply.

Although the Division has had this letter for a month, it does not respond to these five points in its Response. Instead, it simply asserts that *Trimble* is controlling. *Trimble* is a far cry from this case. *Trimble* concerned an ongoing Ponzi scheme that was placed into receivership under the insurance rehabilitation statutes. This case does not involve the insurance statutes or receivership in any form. Nor are there any ongoing transactions to prevent. And there is certainly no Pyramid scheme; the contracts were perfectly valid loan participations, fully backed by loans and titles on each truck. As the Division acknowledges, 93.5% of the investor funds were paid back before the Division ever got involved.³ This is a far better performance than many other investments showed during the financial crises of 2008.

Lastly, *Trimble* relied on the "rule of *nullum tempus occurrit regi* (time does not run against the king)", a rule derived the concept of "a royal prerogative similar to sovereign immunity." *Trimble*, 152 Ariz. at 555, 733 P.2d at 1138. The Division is not the "king", and it enjoys no "royal prerogative". These antiquated notions have been rejected in more recent cases:

We begin by noting that [prior cases] were decided in an era when the government could do no wrong. The rigid rule forbidding estoppel against the government was a logical corollary to the previous notions of sovereign immunity.... Significant changes have since occurred with respect to the sovereign immunity doctrine and, concomitantly, in our view of equitable estoppel against the government.

Valencia Energy Co. v. Arizona Dep't of Revenue, 191 Ariz. 565, 571, ¶¶ 15-16, 959 P.2d 1256, 1262 (1998). The equitable and statutory concerns that animated *Trimble*—a case about shutting down an ongoing fraud—have no place here, and *Trimble's* doctrinal basis,

³ The Division alleges that Concordia raised \$35,206,803, and of that, \$32,929,066 was repaid to the investors as of July 2013. Notice of Opportunity at \$926. \$32,929,066 divided by \$35,206,803 = 0.935304066.

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the royal prerogative concept, has been superseded by more modern cases. Thus, Trimble does not provide the Division a special exemption from the statute of limitations.

C. Text of A.R.S. § 44-2004.

The Division also makes a textual argument against the application of the statute of limitations in A.R.S. § 44-2004. The Division apparently concedes that this case is a "civil action" within the meaning of A.R.S. § 44-2004. But the Division points to the "under this article" language in A.R.S. § 44-2004(A) and (B). The Division then argues that § 44-2004 applies only to actions brought under Title 44, Chapter 12, Article 14, while this case is an enforcement case brought under Title 44, Chapter 12, Article 16.

But the Division does not explain why this case cannot be "under" both Articles 14 and 16, and all of the claims asserted by the Division are directly specified in § 44-2004. For example, A.R.S. § 44-2004(A) refers to claims brought under A.R.S. §§ 44-1841 and 1842, the very statutes the Division relies on for its first two counts. The final count alleges a violation of A.R.S. § 44-1991, and the "statute of limitations applicable to a claim brought under A.R.S. § 44–1991 is stated in A.R.S. § 44–2004(B)" Aaron v. Fromkin, 196 Ariz. 224, 227-28, 994 P.2d 1039, 1042-43 (Ct. App. 2000).

Moreover, even if A.R.S. § 44-2004 does not apply to this action directly, it applies as the most analogous statute of limitations. It "is standard practice for courts to "borrow" a statute of limitations when one is not explicitly provided." Coal River Energy, LLC v. Jewell, ___ F.3d ___, 13-5119, 2014 WL 1887375 (D.C. Cir. May 13, 2014); see also Blood Sys., Inc. v. Roesler, 972 F. Supp. 2d 1150, 1154 (D. Ariz. 2013). This is because: The purpose of [a] statute of limitation ... is ... to (1) prevent the unexpected enforcement of stale and fraudulent claims by allowing persons after the lapse of a reasonable time, to plan their affairs with a reasonable degree of certainty, free from the disruptive burden of protracted and unknown potential liability, and (2) to aid in the search for truth that may be impaired by the loss of evidence, whether by death or disappearance of

⁴ See Motion to Dismiss at 7:1-18 (this case is a civil action); Division Response at 7 (no response on the "civil action" point).

witnesses, fading memories, disappearance of documents or otherwise.".... Therefore, when a statute includes no express statute of limitations, we should not simply assume that there is no limitation period. Instead, we **borrow the most suitable statute of limitations** on the basis of the nature of the cause of action or of the right sued upon.

Bellemare v. Wachovia Mortgage Corp., 931 A.2d 916, 921 (Conn. 2007)(citations and quotation marks omitted)(emphasis added). Here, the most analogous statute of limitations is A.R.S. § 44-2004, which specifically contemplates claims brought under §§ 44-1841, 44-1842, and 44-1991, the exact claims the Division brings in its Notice.

The alternative is that there is simply no statute of limitations, and no limit to how far back in time the Division can go. The 1990's? The 1950's? Statehood? Territorial days? Under the Division's approach, all would be fair game. "Statutes should be construed sensibly to avoid reaching an absurd conclusion." *State ex rel. Montgomery v. Harris*, ___, Ariz. ___, 322 P.3d 160 ¶ 13 (Ariz. April 22, 2014).

D. The restructuring allegations do not apply to the ER Respondents.

The Division alleges that Concordia entered into amendments to its contracts in 2009 and 2011.⁵ To the extent the Division alleges that these restructurings are securities, the Division does not allege the ER Respondents offered or sold the restructuring documents. Instead, the Division vaguely alleges that the ER Respondents "assisted" Concordia.⁶ There is no cause of action for "assisting" a sale. Whatever relevance the restructuring documents may have to the claims against Concordia, they do not support a claim against the ER Respondents.

E. Due process and equitable defenses.

Moreover, if there is truly no statute of limitations that applies to this case, then the case should be dismissed on due process grounds, or on equitable grounds such as latches or estoppel. An administrative proceeding can violate due process if it is unfairly delayed.

⁵ Notice at ¶¶ 27-28.

⁶ Notice, at ¶ 29(e). The ER Respondents will dispute this allegation at the hearing.

See Appeal of Plantier, 494 A.2d 270, 275 (N. H. 1985)("It is fundamentally unfair to make a physician defend a nine-year-old complaint when the complaint was not delayed by fraud or the lack of ability to discover the misconduct"). Alternatively, equitable defenses may also bar such stale claims. "The doctrine of laches applies in administrative proceedings if the challenged administrative action has been unreasonably delayed, resulting in prejudice to a party against whom the action was taken". 2 Am. Jur. 2d Administrative Law § 278.

Here, the ER Respondents are being forced to defend themselves against charges involving 446 alleged "distinct investments" involving "192 investors", when these transactions occurred nine, ten, fifteen or even twenty years ago. In the intervening time, memories have faded, and some documents and witnesses are no longer available. Whether viewed as a matter of the statute of limitations, due process, or latches, the ER Respondents should not be forced to defend these extremely stale claims.

III. As a matter of law, the Servicing Agreements are not securities.

The motion to dismiss provides a detailed explanation of why the Servicing Agreements are not securities. In particular, the motion explained how the actual contracts show that there is no common enterprise, and no expectation of profits from the efforts of others, two requirements of *SEC v. W.J. Howey Co.*, 328 U.S. 293, 300 (1946). Remarkably, the Division offers no *Howey* analysis at all.

The Division concedes, as it must, that the question of whether the agreements are securities is a question of law. Instead of providing an analysis of how Division's alleged facts satisfy the requirements of the *Howey* test, the Division simply argues that there are disputed facts, so the issue cannot be resolved now. The Division cannot avoid a motion to dismiss merely by alleging the agreements are securities; such an allegation is a mere

⁷ Notice at ¶ 26.

⁸ Division Response at 13:3, citing *Nutek Info. Sys., Inc. v. Arizona Corp. Comm'n*, 194 Ariz. 104, 107, 977 P.2d 826, 829 (Ct. App. 1998).

conclusion of law that is not presumed true. In evaluating a motion to dismiss, "we do not accept as true allegations consisting of conclusions of law, inferences or deductions that are not necessarily implied by well-pleaded facts, unreasonable inferences or unsupported conclusions from such facts, or legal conclusions alleged as facts." *Sw. Non-Profit Hous. Corp. v. Nowak*, 685 Ariz. Adv. Rep. 21 ¶ 10, 322 P.3d 204, 208 (Ariz. Ct. App. 2014).

Although the Division claims that there are disputed facts, it does not specifically explain what facts are in dispute, or how its version of the facts would satisfy the *Howey* test. The Division has not disputed that the agreements attached to the motion are the actual agreements used by Concordia. The motion to dismiss explains in detail how these agreements are not securities. The Division has simply failed to make any *Howey* analysis. In the absence of any explanation of how the Division's facts satisfy the *Howey* test, the Commission should grant the motion to dismiss.

IV. The Notice fails to meet the required pleading standards.

A. Non-Fraud Claims.

The Division argues that it does not need to provide "specific instances by specific perpetrator, victim, date, time and location." The Division points to A.A.C. R14-4-306 as trumping the pleading standard of the civil procedure rules. But R14-4-306 does not provide any pleading standard, it merely states "The Commission may issue a notice…"

The Commission's rule regarding pleading standards is A.A.C. R14-3-106(L). That rule provides that "Complaints shall be in writing and shall... a <u>complete statement</u> of the grounds for said complaint, indicating <u>the date or dates</u> of the commission or omission of the acts or things complained of, and the nature of the relief sought by the complainant." A.A.C. R14-3-106(L)(emphasis added). The Notice does not provide any dates of alleged violations, nor does it provide any specific instances to support the claims it makes. No

⁹ Division Response at 11:1-3.

particular investors or transactions are described, even as examples. The Notice speaks only in generalities, yet the Respondents will be expected to provide a defense as to each of the "446 distinct investments" that the Division tells us nothing about.

The Division also cites to A.R.S. § 41-1061(B)(4). But the Commission has the authority to impose a higher pleading standard on itself than set forth in that statute, and as described above it has done so in A.A.C. R14-3-106(L). But even if the statute applies, the Notice fails this lower test as well. The statute requires a "short and plain statement of the matters asserted", which is essentially identical to the civil procedure rules, which require a "short and plain statement of the claim..." Thus, the civil cases cited in the motion are equally applicable to pleading under § 41-1061(B)(4).

Lastly, the Division cites A.A.C. R14-3-101(B), which provides that the Commission's procedural rules should be construed to "secure the just and speedy determination of all matters." To say the least, this reference is ironic given that the Division is pursuing claims from ten or even twenty years ago.

B. Fraud Claims.

The Division also claims that the special rules for pleading fraud in Rule 9(b) do not apply because of the general pleading standard in § 41-1061(B)(4). Because the Commission's rules and the Administrative Procedure Act do not specify a pleading standard for fraud, Rule 9(b) is the more specific provision, and thus controls, under the principle that the more specific rule controls. Any suggestion that regulatory agencies are exempt from Rule 9(b) must be rejected. *S.E.C. v. Tambone*, 417 F. Supp. 2d 127, 131 (D. Mass. 2006)("this

²³ Notice of Opportunity at ¶ 26.

¹¹ Division Response at 11:4. The Division refers to ARS § 41-1061(A)(4), but subsection (B)(4) appears to be the provision they are referencing.

¹² Arizona Rules of Civil Procedure, Rule 8(a).

¹³ See e.g. Arden-Mayfair, Inc. v. State, Dep't of Liquor Licenses & Control, 123 Ariz. 340, 342, 599 P.2d 793, 795 (1979)(specific statute controls over general statute).

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Court rejects the SEC's argument in favor of relaxing the strictures of Rule 9(b)"); S.E.C. v. Kelly, 663 F. Supp. 2d 276, 283 (S.D.N.Y. 2009. Moreover, because a fraud count will turn on what was said, who said it, and who they said it to, the Notice must provide these critical details to enable the Respondents to prepare a defense.

Commission has no jurisdiction over Mrs. Wanzek, an out-of-state spouse.

Under A.R.S. § 44-2031(C), the Commission "may join the spouse in any action authorized by this chapter to determine the liability of the marital community". This statute presumes an Arizona spouse in an Arizona marital community. The Division cites no authority authorizing the Commission to assert jurisdiction over an out-of-state spouse. The Division contends that that there are disputed fact questions about Mr. Wanzek's residence. Accordingly, to supplement Mrs. Wanzek's affidavit, attached as Exhibit 3 is an affidavit from Mr. Wanzek. His affidavit establishes that he spends the majority of the year with his wife in Florida, and that he holds a Florida driver's license, Florida CPA license and is registered to vote in Florida.

The Division points to Mr. Wanzek's Arizona CPA renewal form, where he listed an Arizona address. This form was printed in January 2013, more than a year before the Division filed its case, and does nothing to prove Mr. Wanzek's domicile today. Further, the form does not call for the applicant's domicile, or primary residence, but just a residence. The fact that the Mr. Wanzek maintains a secondary residence in Arizona does not demonstrate he domiciled in Arizona.¹⁴

The Division also states "The Florida Institute of CPAs, which serves as the association for all CPAs certified in Florida, has no listing of Mr. Wanzek." This statement is incorrect. Under Florida law, the agency with regulatory authority over all CPAs is the Board of Accountancy, part of the Florida Department of Business and

¹⁴ As demonstrated in Mr. Wanzek's affidavit, this residence is "under water" that is, the Wanzeks have no equity in the home due to the mortgage. Further, legal title is held by a trustee, not the Wanzeks. ¹⁵ Division Response at 15:22-24.

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Professional Regulation. See FLA. STAT. § 473.303. A copy of Mr. Wanzek's Florida CPA license from that Department is attached to his affidavit.

Thus, the Wanzeks are domiciled in Florida, a non-community property state. There is no marital community for the Commission to exercise jurisdiction against.

VI. Conclusion.

Taking a case like this to trial can <u>easily</u> cost over \$100,000. The Respondents face the daunting prospect incurring burdensome attorney's fees to defend this case if it goes to trial. Yet the Division cannot explain how the facts it alleges meet the *Howey* test for determining whether the agreements are securities. This is a threshold issue; the Respondents should not have to incur the heavy burden of such onerous fees if the agreements are not securities as a matter of law.

Further, the Division's claims relate to transactions from ten, fifteen or even twenty years ago. These stale claims are barred by the statute of limitations, by due process or by latches. Again, these are threshold issues; the Respondents should not be forced to incur massive, crippling fees to defend themselves from stale, time-barred claims.

And if a trial is necessary, the Notice fails to provide the Respondents with even the minimum information they need to begin to prepare for trial. The allegations are entirely generic; there is no detail as to investors, dates, amounts, or representations made in individual circumstances. The relevant pleading standards—whether they be the civil rules, the Commission's rules or the Administrative Procedure Act—require the Defendants be given this basic information.

Lastly, the overwhelming evidence is that the Wanzeks are domiciled in Florida. There is no Arizona marital community to justify naming Mrs. Wanzek.

Alan S. Baskin, Esq.
David E. Wood, Esq.
Baskin Richards, PLC
80 East Rio Salado Parkway, Suite 511
Tempe, Arizona 85281
Attorneys for Concordia Finance Company, LTD.

By Jackyn Howard

Exhibit

"1"

COMMISSIONERS
BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

JODI JERICH EXECUTIVE DIRECTOR



MATTHEW J. NEUBERT DIRECTOR

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ARIZONA CORPORATION COMMISSION

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April 8, 2014

By First Class Mail and Email

Timothy J. Sabo, Esq. Roshka DeWulf & Patten, PLC 400 E. Van Buren St., Suite 88 Phoenix, AZ 85004 tsabo@rdp-law.com

RE: Docket No. 2-20906A-14-0063; In re: Concordia Financing Co., Ltd., et al.,

Arizona Corporation Commission

Dear Mr. Sabo:

I am in receipt of the *Motion to Dismiss and Answer* filed in the above-referenced proceeding on behalf of the ER Entities on April 4, 2014. In the motion, you argue as bases for dismissal the expiration of the statutes of limitations codified at A.R.S. § 44-2004. You support your argument with citation to several court opinions rendered over the course of 209 years in a variety of jurisdictions.

During the extensive research that must have gone into such an argument, how is it that you did not come across *Trimble v. American Savings Life Ins. Co.*, 152 Ariz. 548, 733 P.2d 1131 (App. 1986)? In *Trimble*, the Court of Appeals of Arizona specifically addresses the application of § 44-2004 to claims asserted by, among other agencies, the Arizona Corporation Commission. In it, the court holds that a state agency is exempt from the statutes of limitations in § 44-2004 when the agency pursues an action in the public interest, as the Division has done here. 152 Ariz. at 554-556, 733 P.2d at 1137-1139. A copy of the opinion is enclosed.

The *Trimble* opinion is controlling, directly on point, and counter to your statute of limitations argument. A reasonable inquiry would have led you to the opinion. Your failure to address it in the *Motion to Dismiss and Answer* constitutes a violation of Rule 11(a) of the Arizona Rules of Civil Procedure.

If, **by Wednesday, April 16, 2014**, you fail to amend your *Motion to Dismiss and Answer* to either withdraw the statute of limitations arguments or explain why *Trimble* is inapposite, the Division will seek sanctions against you, including the reasonable attorney's fees incurred in addressing this matter.

Mr. Sabo April 8, 2014 Page 2 of 2

Please feel free to contact me regarding any questions or comments you may have regarding this matter.

Sincerely,

Stephen J. Womack Enforcement Attorney

Encl.

Cc. Alan S. Baskin, Esq., Bade Baskin Richards, PLC (by email)

Page 1

733 P.2d 1131 152 Ariz. 548, 733 P.2d 1131, Blue Sky L. Rep. P 72,454 (Cite as: 152 Ariz. 548, 733 P.2d 1131)

C

Court of Appeals of Arizona,
Division 1, Department D.

J.N. TRIMBLE, Director of Insurance, the Arizona
Corporation Commission, body
politic, and Matthew J. Zale, Director of Securities,
Plaintiffs-Appellees,
Cross-Appellants,

AMERICAN SAVINGS LIFE INSURANCE COMPANY, an Arizona corporation, Frihoff N. Allen, Joseph L. Allen, Evan C. Porter, Gerald M. Allen, Taft L. Allen, Elijah C. Allen, Orrin C. Fuller, Clark E. Allen, Richard B. Young and John Does I-L, Defendants-Appellants, Cross-Appellees. No. 1 CA-CIV 8003.

Oct. 23, 1986.
Reconsideration Denied Dec. 10, 1986.
Review Denied March 11, 1987.

Following finding that insurance company was guilty of securities and insurance fraud, the Superior Court, Maricopa County, No. C-346842, Rufus C. Coulter, Jr., J., entered judgment approving plan of reorganization. Insurance company appealed, and State cross-appealed. The Court of Appeals, Grant, P.J., held that: (1) insurance company was not entitled to modification of plan of reorganization or evidentiary hearing prior to decision on facts surrounding each individual's investment; (2) application of statute of limitations improperly denied rescission option to all investors; and (3) award of prejudgment interest was within trial court's discretion.

Affirmed in part, reversed in part and remanded.

West Headnotes

11 Securities Regulation 297 349Bk297 Most Cited Cases

In public action involving securities fraud, if plaintiffs are so numerous as to make it infeasible to determine individual reliance, or if claim is based on omitted material fact, constructive reliance will be found. A.R.S. § § 44-1991, 44-1992.

121 Securities Regulation 278
349Bk278 Most Cited Cases

Company selling securities has affirmative duty not to mislead potential investors. A.R.S. § § 44-1991, 44-1992.

[3] Securities Regulation 297 349Bk297 Most Cited Cases

In action for securities fraud, there is no need to investigate whether omission or misstatement was actually significant to particular buyer. A.R.S. § § 44-1991, 44-1992.

[4] Securities Regulation 297 349Bk297 Most Cited Cases

Insurance company found guilty of securities and insurance fraud was not entitled to opportunity to disprove causation as to each investor where trial court found that misrepresentations and omissions made by insurance company were substantial factor in reasonable buyer's decision to invest. A.R.S. § § 44-1991, 44-1992.

By continuing to accept performance known to be deficient, one waives right to reject contract.

161 Securities Regulation 299 349Bk299 Most Cited Cases

Investors who continued to pay premiums on fraudulent securities scheme and who failed to tender securities back to insurance company after receiving notice of fraud on part of insurance company did not waive their right to rescind investment packages where, if investors discontinued premium payments, they received minimum return and, by continuing to make payments, they could hope to salvage any possible value of original transaction. A.R.S. § § 44-1991, 44-1992.

171 Compromise and Settlement 7.1 89k7.1 Most Cited Cases (Formerly 89k7)

To be given final effect, settlement must be entered into fairly and in good faith.

181 Insurance 1412 217k1412 Most Cited Cases (Formerly 217k72.9)

Investors who terminated their payments to insurance company found guilty of securities and insurance

(Cite as: 152 Ariz. 548, 733 P.2d 1131)

fraud with respect to investment programs were not barred from recovering under claims for fraud pursuant to plan of reorganization where plan provided that lapsed policies were covered by plan, but that transactions terminated by litigation or compromise were not. A.R.S. § § 44-1991, 44-1992.

[9] Limitation of Actions € 11(1)

241k11(1) Most Cited Cases

Commissioner of Insurance, bringing action to recover damages caused by corporate mismanagement of insurance company, was immune from statute of limitations defense, despite ancillary benefit from action to investors, as legislative intent of insurance rehabilitation statutes was to benefit public generally.

1101 Limitation of Actions 11(1)

241k11(1) Most Cited Cases

Rule that state is immune from statutes of limitation applies if right which governmental unit seeks to assert is in fact right belonging to general public.

111 Limitation of Actions 11(1)

241k11(1) Most Cited Cases

Fact that relief sought by state will recompense individual member of public does not necessarily diminish interest or authority of state in prosecuting action for purposes of rule holding state immune from statutes of limitations.

112 Limitation of Actions 11(1)

241k11(1) Most Cited Cases

Statutes of limitation in public enforcement actions, as opposed to criminal prosecutions, do not run against state unless legislature has expressly and definitely declared that they do.

[13] Securities Regulation 5309 349Bk309 Most Cited Cases

Whether expenses such as sales commissions, selection and issue costs, premium taxes, and maintenance costs should be included in fair cost of life insurance sold as part of fraudulent investment package by insurance company is for trial court to determine in exercise of its discretion.

[14] Securities Regulation 5309 349Bk309 Most Cited Cases

Decision to exclude expenses for commissions, selection, and issue costs from offset for fair cost of life insurance sold as part of fraudulent investment package was not abuse of discretion where face

amount of each policy did not reflect its actual value, and insurance policies were secondary in importance to whole investment package.

Page 2

[15] Interest \$\infty\$ 39(2.15)

219k39(2.15) Most Cited Cases

Liquidated claim generally entitles its holder to prejudgment interest. A.R.S. § 44-1201, subd. A.

[16] Interest 6 19(1) 219k19(1) Most Cited Cases

Where there is liquidated claim and unliquidated offset, offset does not render entire claim unliquidated.

[17] Interest 5 39(2.6)

219k39(2.6) Most Cited Cases

(Formerly 219k39(2.5))

Award of prejudgment interest may serve not only to recompense victim, but to deter defendant from attempting to benefit from delays in litigation.

[18] Interest 539(2.50) 219k39(2.50) Most Cited Cases

Defrauded investors were entitled to prejudgment interest following return of consideration to investors, even if court-ordered offset in amount equal to fair cost of effective insurance coverage provided to investor was unliquidated, where claim involved was for consideration paid, and defendants engaged in protracted litigation which significantly delayed their having to return consideration to investors. A.R.S. § 44-1201, subd. A.

|19| Interest @== 39(1)

219k39(1) Most Cited Cases

Insurance company found guilty of securities and insurance fraud was liable for interest for time when insurance company was enjoined from contacting investors to settle their claims, where injunction did not prohibit insurance company from settling claims, and injunction did not require insurance company to segregate rescission funds. A.R.S. § 44-1201, subd. Α.

|20| Interest € 46(1)

219k46(1) Most Cited Cases

Defrauded investors were not required to make demands of payment to insurance company for return of consideration paid in order to be entitled to prejudgment interest where investors were unaware of nature of scheme until complaint was filed and trial exposed fraud, need for each investor to bring

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suit on his or her own against insurance company was obviated by state's suit which sought relief for investors, and insurance company was protected from suit by injunction which prohibited investors from filing suit unless they first obtained court permission to do so.

1211 Interest 39(2.50) 219k39(2.50) Most Cited Cases

Award of prejudgment interest on total premiums paid pursuant to fraudulent scheme before premiums were offset by mortality expenses incurred by insurance company was proper. A.R.S. § 44-2001.

**1133 *550 Robert K. Corbin, Atty. Gen. by Patrick M. Murphy, Chief Counsel Financial Fraud Div., Phoenix, for plaintiffs-appellees, cross-appellants.

Beus, Gilbert, Wake & Morrill by Neil Vincent Wake, Phoenix, and Wentworth & Lundin by Robert Ong Hing, Scottsdale, and Gove L. Allen, Mesa, for defendants-appellants, cross-appellees.

Warner Angle Roper & Hallam, P.C. by Jerry L. Angle, Phoenix, Deputy Receiver.

OPINION

GRANT, Presiding Judge.

This is an appeal by American Savings Life Insurance Company and its officers, directors, and executives (American Savings) from the trial court's adoption of a plan of reorganization. The state has cross-appealed.

FACTS

On March 2, 1977, the State of Arizona (State) filed a lawsuit, through the directors of insurance and securities, against American Savings. The suit alleged a securities and insurance fraud involving the sale of an investment package called the Inflation Beater. [FN1] The complaint asked for injunctive relief and an order appointing an agent of the court to supervise the orders prayed for, and relief for the purchasers of the Inflation Beater.

FNI. The "Inflation Beater" is also referred to as "Third Party Security Agreement." For purposes of continuity, we refer to both the Inflation Beater and Third Party Security Agreement transactions as Inflation Beaters.

The Inflation Beater comprised two basic parts, life insurance and stock. A typical investor purchased a

\$20,000 face amount life insurance policy for an annual premium of \$600. Simultaneously, he signed a promissory note for \$10,000. In exchange he received 2.000 shares of American Savings stock at \$5 per share. The company told the investors it would repurchase the shares for one dollar per share. An investor did not have to make payments on the note as long as he paid the insurance premium. The note was secured by the company's possession of the stock certificates, the investor's assignment of the cash value and death benefits of the insurance policy to American Savings, up to the amount of the note, and stock and cash dividends. The investor had no right to sell or assign his stock until the stock note was paid in full.

The net result of the Inflation Beater was that the face amount of the life insurance policy did not reflect the actual benefits payable under the policy. Actual payments *551 **1134 to a beneficiary would be the face amount minus the note (and interest as required in some contracts), presumably plus a promised repurchase of stock by American Savings at \$1.00 per share for each released share.

At trial, the State proved that the Inflation Beater was a pyramid scheme. American Savings's impressive financial statements were found to be the result of accounting practices constituting "a device, scheme, or artifice to defraud and an omission to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading," a violation of A.R.S. § 44-1991. The court noted that:

the prospectus and other related financial reports were of such a nature that only a person well trained in accounting or a very sophisticated investor could have ascertained the stock pyramid that was occurring. In the beginning, it is doubtful that even an accountant or a sophisticated investor would have foreseen the ultimate results.

The trial court set out the accounting principles violations committed by American Savings <u>[FN2]</u> and found that:

FN2. The company's stock has a par value of 10 cents per share. From the \$10,000.00 note, \$200.00, the par value of 2,000 shares, would go to paid-in capital and the balance of \$9,800.00 would go to capital in excess of par. Following this procedure, the stock notes in 1976 equalled approximately \$22,000,000.00 of the company's total assets of approximately \$32,000,000.00, or in

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> other words well over one-half of the company's total assets. Based on these "ever increasing assets and growth" stock dividends were declared at the rate of three 10 percent stock dividends per year. The stock dividends were not based on the earnings of the company but were based on the continuous sale of stock. When stock dividends were declared, the company would transfer 10 cents per share, the par value, for each share from capital in excess of par to the paid-in capital account. Under the program as it existed, the only way the company could have continued with stock dividends as it had been doing for the past four years was by the continued sale of stock.

> > * * *

Under the financial structure of the company as it existed, the investors' only hope of getting even or ahead as was projected would be to continue to receive the pyramiding stock dividends coupled with the continued ability to sell the stock at \$1.00 per share.

treatment of the stock notes as an asset at full face value, particularly without a full, complete and adequate disclosure, is not consistent with generally accepted accounting principles and likewise constitutes a violation of A.R.S. [§] 44-1991, as well as A.R.S. [§] 44-1992.

As a result of the violation of A.R.S. § § 44-1991 and 44-1992, the trial court issued its order on September 26, 1977 permanently enjoining American Savings from selling the Inflation Beater and appointing Phoenix attorney Jerry Angle as an "agent of the court." The order also directed the parties to prepare a plan of reorganization. On July 11, 1978, the court found that "the insurer has wilfully violated the laws of the State of Arizona." It appointed J.N. Trimble, the Director of Insurance, as the statutory receiver for American Savings, and designated Jerry Angle as a deputy receiver, pursuant to A.R.S. § 20-631.

American Savings appealed. This court affirmed the injunction and appointment of a receiver. Trimble v. American Savings Life Insurance Company, 1 CA-CIV 4488 and 1 CA-CIV 4489 (consolidated) (Memorandum Decision filed September 24, 1981) (two judges concurring). No program for rescission was before the court in the

Trimble memorandum decision. The case was remanded to the trial court for further necessary proceedings.

The trial court undertook to adopt a plan of reorganization. It received evidence on the issues relevant to rescinding the Inflation Beater packages. On June 15, 1984, the court entered its judgment approving a plan of reorganization. American Savings appealed and the State cross-appealed. Specifics of the plan will be set forth as needed for resolution of the issues raised in the appeal and cross-appeal.

The issues raised by American Savings may be divided into three broad categories: whether American Savings is entitled to a hearing on the merits of each investor's **1135 *552 claim; whether the award of prejudgment interest was proper; and, whether the trial court correctly applied the securities violation statute of limitation. The State's cross-appeal also questions the correctness of the trial court's application of the statute of limitation.

LITIGATION OF INDIVIDUAL CLAIMS

American Savings seeks a remand to have each investor's claim litigated on the issues of reliance, causation, materiality and due diligence. It claims this right on two theories: these are elements of the securities statutes which must be proven by a plaintiff, or they are affirmative defenses, which the defendant must have an opportunity to present as a matter of due process; and, the insurance rescission statute, A.R.S. § 20-628, requires a hearing on the validity of each individual claim. However, we note that if the investors' reliance, causation, materiality and due diligence are not elements of or valid defenses to the state's claim, no hearing is required under either theory; the issues are simply irrelevant.

Arizona Revised Statutes, § 44-1991 states:

- It is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities ... directly or indirectly to do any of the following:
- 1. Employ any device, scheme or artifice to defraud.
- 2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
- 3. Engage in any transaction, practice or course of

business which operates or would operate as a

Arizona Revised Statutes, § 44-1992 states:

fraud or deceit.

It is a fraudulent practice and unlawful:

- 1. For a person to subscribe to or make or cause to be made an untrue statement of a material fact in an application, registration statement, prospectus, financial statement or document required to be filed under any provision of this chapter or any rule, regulation or order of the commission thereunder.
- 2. To omit or cause to be omitted from any such application, registration statement, prospectus, financial statement, or other statement or document, a material fact or statement necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

The trial court found that American Savings implemented a sophisticated scheme to defraud purchasers of the Inflation Beater through, among other things, improper accounting practices, financial statements which greatly inflated the company's assets, and the use of stock dividends to project the illusion of growth. These, according to the trial court, were omissions of material fact and violations of both sections, A.R.S. § § 44-1991 and 44-1992.

The defendant argues that the trial court failed to accord it an opportunity to disprove reliance, due diligence and causation as to each investor. The Arizona Court of Appeals has held that reliance upon a misrepresentation is not an element of § 44-1991, the antifraud provision of our securities law. Rose v. Dobras. 128 Ariz. 209, 214, 624 P.2d 887, 892 (App.1981); cf. Washington Nat'l Corp. v. Thomas. 117 Ariz. 95, 570 P.2d 1268 (App.1977).

[1] To the contrary, federal courts have interpreted § 44-1991 to require a plaintiff in a nonpublic action to prove he reasonably relied on defendant's misstatements and was unaware of the untruth or omission of fact. McDaniel v. Compania Minera Mar de Cortes, 528 F.Supp. 152, 166 (D.C.Ariz.1981). However, the instant case is a public, not a private, action. In addition, if the plaintiffs are so numerous as to make it infeasible to determine individual reliance, **1136*553 Mills v. Electric Light Co.. 396 U.S. 375, 382 n. 5, 90 S.Ct. 616, 620 n. 5, 24 L.Ed.2d 593, 601 n. 5 (1970), or where the claim is based on an omitted material fact, Affiliated Ute Citizens v. United States, 406 U.S. 128, 152-53, 92 S.Ct. 1456, 1471-72, 31 L.Ed.2d 741, 761 (1972),

federal courts will find constructive reliance. 5 A.S. Jacobs, *Litigation and Practice Under Rule 10b-5* § 624.01(b)(i) (2d ed. 1986 revisions). This exception would apply in this case.

Moreover, reliance is not an element of § 44-1992. This section addresses incorrect statements made to the state, whether or not made to investors. Therefore, whether the investors relied upon those misrepresentations has no bearing on the purpose of § 44-1992. See State v. Tarzian, 136 Ariz. 238, 665 P.2d 582 (App.1983); Barnes v. Vozack, 113 Ariz. 269, 550 P.2d 1070 (1976).

[2] Defendants also claim that investors must act with due diligence and that they would have discovered any misrepresentations had they so acted. Defendants' argument is unfounded. The statutes do not require investors to act with due diligence; nor do we find any judicial authority in Arizona for such a requirement. To the contrary, defendants have an affirmative duty not to mislead potential investors. Washington Nat'l v. Thomas, 117 Ariz, at 102, 570 P.2d at 1275. This requirement not only removes the burden of investigation from an investor, but places a heavy burden upon the offeror not to mislead potential investors in any way. The trial court has correctly found against the defendants.

Finally, defendants claim that they are entitled to a hearing on the issue of whether their alleged misstatements caused the victim's injuries. In Arizona, the requirement of causation has been suggested as an element of a § 44-1991(2) violation. Washington Nat'l v. Thomas, 117 Ariz. at 101, 570 P.2d at 1274. It is unclear from the statutory language whether causation is an element of A.R.S. § 44-1991(1) or § 44-1992. Under § 10(b) and rule 10b-5 of the 1934 Securities Exchange Act, some causal nexus must exist between a defendant's acts and the plaintiff's injury. 5 A.S. Jacobs, § 64.02, at 3-332.

[3] Federal courts find that the "plaintiff succeeds in proving causation for securities fraud once the misstatement or omission has been shown to be 'material.' " Plaine v. McCabe, 797 F.2d 713, 721 n. 15 (9th Cir.1986), citing Vaughn v. Teledyne, Inc., 628 F.2d 1214 (9th Cir.1980). Materiality is an element of § \$ 44-1991(2) and 44-1992. Arizona has previously adopted an objective test for materiality. The test to be met is simply a showing of substantial likelihood that, under all the circumstances, the misstated or "omitted fact would have assumed actual significance in the

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deliberations" of a reasonable buyer. Rose, 128 Ariz. at 214, 624 P.2d at 892, quoting TSC Indus. v. Northway. Inc., 426 U.S., 438, 96 S.Ct., 2126, 48 L.Ed.2d 757 (1976). Under this test, there is no need to investigate whether an omission or misstatement was actually significant to a particular buyer. See A.S. Jacobs, § 61.02. Thus, the same objective test is used to establish both materiality and causation.

[4] The trial court's finding of materiality under § 44-1991(2) constitutes its determination that the misrepresentations and omissions made by the defendants were a substantial factor in a reasonable buyer's decision to invest. We see no reason to require individual determinations as to causation. The trial court's finding is reasonably supported by the evidence. The misrepresentations concerning the value of the stock, the company assets and stock dividends directly relate to the attractiveness of the investment. See Harmsen v. Smith, 693 F.2d 932, 946 n. 11 (9th Cir. 1982), cert. denied, 464 U.S. 822, 104 S.Ct. 89, 78 L.Ed.2d 97 (1983):

Proof of each plaintiff's reliance on the misrepresentations or omissions is not a prerequisite to recovery.... [I]f omissions or nondisclosures meet the standards of materiality to a reasonable investor, causation and reliance can be assumed.

**1137 *554 American Savings next argues that by continuing to pay premiums on the Inflation Beater and failing to tender the securities back to it after receiving notice of fraud the investors waived any right to rescind.

[5][6] It is a generally accepted rule of contract law that by continuing to accept performance known to be deficient, one waives the right to reject the contract. Smith v. Hurley. 121 Ariz. 164, 589 P.2d 38 (App.1978). This rule is predicated on the assumption that one seeking to rescind would be unjustly enriched by receiving the benefits under the contract as well as the consideration. However, the general rule is inapplicable in the instant case. Defendants have committed a fraud upon the investors. This fraud has put the investors in a nowin situation. If the investors discontinued premium payments, they received only a few shares of stock and the minimal cash surrender value of the life By continuing to make the insurance policy. payments they could hope to salvage any possible value of the original transaction. Tendering the stock for cash is an inadequate remedy as well. This situation is a far cry from that for which the rule was created. We therefore decline to apply it to the facts

of this case.

The defendants also argue that those investors who terminated their payments are likewise barred from recovery. The defendants, calling the termination a "mutual cancellation," reason that the victims have elected their remedy by allowing the company to terminate the policy and apply the cash surrender value to the note.

[7][8] This claim is equally without merit. By it, defendants attempt to characterize the termination of payments as a settlement. The plan recognized this as erroneous by specifically providing that lapsed policies are covered by the plan while transactions terminated by litigation or compromise are not. To be given final effect, a settlement must be entered into fairly and in good faith. Shelton v. Grubbs, 116 Ariz. 230, 568 P.2d 1128 (1977). By discontinuing payments, it cannot be said that the investors intended to relinquish all claims for fraud, and thus elected their remedy. Under the defendants' reasoning, both those continuing and those discontinuing premium payments are barred from further recovery. This would leave no victims to be compensated. This result is clearly contrary to the entire purpose of the plan of reorganization and we reject these arguments.

American Savings also contends that it is entitled to a hearing pursuant to A.R.S. § 20-628 on each investor's claim in order to raise "various denials or defenses" such as lack of reliance, causation, materiality and due diligence. Because we hold that these "denials and defenses" are not available, we see no reason for such hearings.

STATUTE OF LIMITATIONS

The plan of reorganization gave an option of rescission of Inflation Beaters to investors who purchased packages on or after March 1, 1974. The trial court did not explain why only those investors purchasing after March 1, 1974 were entitled to elect rescission. It may have believed that A.R.S. § 44-2004 required it to do so.

The applicable statute is as follows:

No civil action shall be brought under this article to enforce any liability founded upon the violation of article 13 [which includes A.R.S. § § 44-1991] and 44-1992] unless brought within one year of the discovery of the fraudulent practice upon which the liability is founded, or after such discovery should have been made by the exercise of reasonable diligence, and in no event shall such action be

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brought more than three years after the fraudulent practice occurred. [FN3]

FN3. Effective until August 27, 1977. Laws 1977, Ch. 76, § 10. The subsequent version deleted "and in no event shall such action be brought more than three years after the fraudulent practice occurred" and lengthened the limitations period from one to two years.

A.R.S. § 44-2004(B).

We have considered the several arguments in the appeal and cross-appeal on **1138 *555 statutory interpretation of this section on whether various exceptions should toll or bar application of the statute of limitations. These issues include:

- 1. whether this is a public enforcement action so that the state is immune from the defense of statute of limitations;
- 2. whether the injunction prohibiting investors from filing suit against American Savings without first obtaining court permission tolled the statute;
- 3. whether the trial court correctly determined that the state's complaint triggered the application of the statute;
- 4. whether the doctrine of fraudulent concealment tolled application of the statute.
- [9] We conclude that the state is immune from the statute of limitations defense, despite the ancillary benefit from this action to investors. The trial court's application of the statute of limitations to this case was erroneous and we reverse on that point. Our conclusion renders resolution of the other limitations issues unnecessary.

At common law, the state was immune from statutes of limitation under the rule of nullum tempus occurrit regi (time does not run against the king). Although the doctrine was originally established as a royal prerogative similar to sovereign immunity, its role under modern law is to prevent the public from suffering "because of the negligence of its officers and agents' in failing to assert causes of action which belong to the public." City of Shelbyville v. Shelbyville Restorium, 96 Ill.2d 457, 459. 71 Ill.Dec. 720, 722, 451 N.E.2d 874, 876 (1983). The rule is recognized in Arizona. City of Bisbee v. Cochise County, 52 Ariz. 1, 10, 78 P.2d 982, 985 (1938).

[10][11] The rule applies if the right which the governmental unit seeks to assert is in fact a right belonging to the general public. It does not apply if the right belongs only to the government or to some small and distinct section of the public. The fact that the relief sought by the state will recompense an individual member of the public does not necessarily diminish the interest or authority of the state in prosecuting the action. See, e.g., City of Shelbyville. 96 III.2d 457, 71 III.Dec. 720, 451 N.E.2d 874 (1983) (state action to force contractor to pave subdivision); United States v. Sheff, 194 F.2d 596 (9th Cir.1952) (action by the federal government for restitution to victims of housing rental overcharges not barred by statute of limitations); Securities & Exchange Comm'n v. Penn Central Co., 425 F.Supp. 593, 599 (E.D.Pa.1976) (disgorgement does not render securities enforcement action predominantly one for private benefit; statute of limitations defense not applicable); State v. Brotherhood Bank and Trust Co., 8 Kan. App. 2d 57, 649 P.2d 419 (1982) (statute of limitations not applicable to state collecting damages for aggrieved consumers under Kansas Consumer Protection Act).

The case of Herrmann v. Cissna. 82 Wash.2d 1, 507 P.2d 144 (1973) is particularly instructive on the issue of whether the state herein is subject to the affirmative defense of the statute of limitations. Herrmann, the commissioner of insurance, brought suit to recover damages caused by corporate mismanagement of an insurance company. Washington Supreme Court recognized that the action would benefit the insurance company, and that the policy holders would be the real beneficiaries. Nonetheless, the action was held to be one for the public, not subject to a statute of limitations, because the insurance rehabilitation statutes were enacted in the interest of the public generally. "Actions taken by the commissioner in the discharge of his statutory responsibilities while they undoubtedly benefit some private parties, are taken primarily in the public interest...." Id. at 6, 507 P.2d at 147.

We agree that the proper focus must be on the legislative intent of insurance rehabilitation statutes: to benefit the public generally. When an insurer commits acts which are grounds for rehabilitation, such as violation of the Arizona securities laws, the corrective measures taken by the state through the director of insurance benefit **1139 *556 the public as a whole. The public interest is served by the cessation of illegal and fraudulent acts. Requiring the insurer to make restitution to the victims has a

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deterrent effect, which also serves the public interest. *Id.*

We emphasize the importance of the insurance rehabilitation statutes in this matter. The earlier Trimble memorandum decision and its concurrence agreed that A.R.S. § 20-620(A) [FN4] authorized the director to formulate a rescission option. The fact that the action in its present status is directed toward remedies for individuals does not diminish the public interest nature of the proceeding.

FN4. A.R.S. § 20-620(A) reads, "An order to rehabilitate a domestic insurer shall direct the director ... to take such steps toward removal of the causes and conditions which have made rehabilitiation necessary as the court may direct."

[12] Finally, the language that A.R.S. § 44-2004(B) applies to any "civil action" does not change our Statutes of limitation in public conclusion. enforcement actions as opposed to criminal prosecutions do not run against the state "unless the legislature has expressly and definitely declared that they do." City of Bisbee v. Cochise County, 52 Ariz. at 10, 78 P.2d at 985. See State v. Gunnison, 127 Ariz. 110, 618 P.2d 604 (1980) (Holohan, J. specially concurring). Unless the legislature expressly declares that a statute of limitations bars an action brought for the public benefit we will not give it effect. See Estate of O'Connor v. Arizona Dept. of Rev., 139 Ariz. 450, 679 P.2d 96 (App. 1984).

Since we see no basis for the March 1, 1974 limitation on the option of rescission, in the further proceedings upon remand required in this matter, all purchasers of the Inflation Beater packages shall be entitled to exercise the option of rescission. We remand with directions to modify the plan of reorganization accordingly.

ITEMS INCLUDED IN THE FAIR COST OF INSURANCE

As noted above, American Savings complains about the trial judge's decision to exclude various expenses from the offset for the fair cost of the life insurance sold as part of the Inflation Beater package.

At the hearing the state's expert witness testified that under the facts of this case, only mortality expenses should be allowed. The defendant's witness gave higher estimates of those expenses, and included expenses such as commissions, selection and issue costs as fair costs of insurance. However, he learned

of the finding of fraud against American Savings for the first time at the hearing—after he had given his estimates.

[13][14] Whether expenses such as sales commissions, selection and issue costs, premium taxes and maintenance costs should be included in the fair cost of insurance was for the trial court to determine in the exercise of its discretion. <u>Rose v. Dobras, 128 Ariz. at 215, 624 P.2d at 893.</u> There is no clear abuse of that discretion, particularly in this case where the face amount of each policy did not reflect its actual value.

The defendant cites authority for the proposition that one rescinding an insurance contract must pay for benefits received. This authority is inapplicable because it deals solely with insurance policies. The insurance policies in this case were secondary, and sometimes incidental, in importance to the whole Inflation Beater package. Many investors bought the life insurance only because they were told they could not purchase the stock otherwise. Indeed, one investor testifying at the October 1983 hearing was told by the insurance agent that a discrepancy in her policy concerning the amount of coverage "didn't The insurance policies in this case were merely a vehicle for perpetrating the larger securities fraud. Clearly, the expenses of perpetrating a fraud are not fair costs, or ones for which the perpetrator should be recompensed by the victim. The offset for only mortality expenses seems most logical because they are some of the few expenses which relate directly to the life insurance. The trial judge's ruling that only mortality expenses should be included in the offset is affirmed.

**1140 *557 PREJUDGMENT INTEREST

The trial judge ordered that:

[a]Il payments payable by American to investors under the terms of this plan shall bear interest from the date of payment to American by the investor at the rate of six percent (6%) per annum until January 1, 1980, and ten percent (10%) per annum from January 1, 1980, until paid.

The increased interest rate reflects the change in the legal rate of interest from six percent to ten percent, A.R.S. § 44-1201(A) (as amended by Laws 1980 2d S.S., Ch. 2, § 4, effective December 14, 1979).

[15] The general rule in Arizona is that a liquidated claim entitles its holder to prejudgment interest. As this court explained, "[a] claim is liquidated if the evidence furnishes data, which, if believed, makes it

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possible to compute the amount with exactness, without reliance on opinion or discretion." Autonumerics, Inc. v. Bayer Indus., 144 Ariz., 181, 193, 696 P.2d 1330, 1342 (App. 1984), citing Arizona Title Ins. v. O'Malley Lumber, 14 Ariz. App. 486, 484 P.2d 639 (1971). See also Lake Havasu Community Hosp. v. Arizona Title Ins., 141 Ariz., 363, 378, 687 P.2d 371, 386 (App. 1984).

The core of the dispute centers on whether the "fair cost of insurance" is a liquidated claim by American Savings. The reorganization plan provided that an investor who chose to rescind the inflation beater package would receive the consideration paid, plus interest, less "an amount equal to the fair cost of the effective insurance coverage provided to the investor." The fair cost of insurance was defined by the trial court as mortality expenses, determined by reference to a particular table on mortality, applied to the face amount of the policy. The judge arrived at this definition after considering expert testimony presented in an October, 1983 hearing.

The plan's definition of the fair cost of insurance was far narrower than that proposed by American American Savings sought to include Savings. mortality expenses, selection and issue costs, maintenance costs, premium taxes and sales American Savings argues that there commissions. are genuine disputes over the fair cost of insurance sufficient to prevent the claim from being liquidated. The State's response is that there was no real dispute among the experts over this issue and that the claim It further argues that was therefore liquidated. A.R.S. § 44-2001, allowing a purchaser of a voidable security to "recover the consideration paid for the securities, with interest thereon," permits an award of prejudgment interest even on unliquidated claims.

In their rush to characterize the *insurance* costs as liquidated or unliquidated, both parties have mischaracterized the claim. The claim involved is that for consideration paid. This claim is clearly liquidated. The amount paid by investors is easily ascertainable without reliance on opinion or discretion. Neither side questions what amount was paid by investors as consideration.

[16] The "fair cost of insurance" is merely an offset, not a claim. The only possible unliquidated aspect of the claim is the amount of this offset. When there is a liquidated claim and an unliquidated offset, the offset does not render the entire claim unliquidated.

It appears to be the well-recognized rule that if the amount due under a contract is ascertainable, but is reduced by the existence of an unliquidated set-off or counterclaim, attributable to the contract, interest is properly allowable on the balance found due from the due date.

Homes & Son Construction Co. v. Bolo Corp., 22 Ariz. App. 303, 306-07, 526 P.2d 1258, 1261-62 (1974) (dictum). Consequently, while the fair cost of insurance may have been an unliquidated amount, that fact does not change the liquidated nature of the claim, i.e. consideration paid. The amount of the offset is within the trial court's discretion. Rose v. Dobras, 128 Ariz. at 215, 624 P.2d at 895.

[17] We believe that an award of prejudgment interest may serve not only to recompense the victim but to deter defendants from attempting to benefit from delays *558 **1141 in litigation. See General Facilities, Inc. v. National Marine Service, Inc., 664 F.2d 672, 674 (8th Cir.1981). Such an award promotes the legislative purpose evidenced by the adoption of the legislation giving rise to the claim. See Garcia v. Burlington Northern R.R., 597 F.Supp. 1304, 1307 (D.C.Colo.1984).

[18] In the present case, defendants received insurance premiums over a period of time beginning more than ten years ago. For whatever reason, defendants have engaged in protracted litigation since 1977 which has delayed significantly their having to return the consideration to investors. The legislature has expressed an intent through its statutes to stem the defrauding of innocent investors. A prejudgment interest award is particularly appropriate in such cases. See Myron v. Chicoine, 678 F.2d 727, 733 (7th Cir.1982); Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1051 (7th Cir.) cert. denied, 434 U.S. 875, 98 S.Ct. 224, 54 L.Ed.2d 155 (1977). Given these considerations, the trial court was well within its discretion in awarding prejudgment interest. Because we hold that the amount in dispute was a liquidated claim with an offset, we need not reach the question of whether A.R.S. § 44-2001 by its terms allows prejudgment interest on unliquidated claims.

As a final matter, the parties very briefly debate the trial court's failure to suspend the accrual of interest for the time when American Savings was enjoined from contacting investors to settle their claims. American Savings cites two cases for the proposition that interest should not be awarded when a litigant is precluded from settling a claim because of judicial restraint. Gaston v. Shunk Plow Co., 161 Ga. 287, 130 S.E. 580 (1925); Ide v. Aetna Ins., 232 Mass.

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523, 122 N.E. 654 (1919).

The rule recited by American Savings appears to be a correct statement of the general law.

Persons who are prevented from paying over money by process of the court, such as writs of injunction and the like, are not liable for interest. This is so because it would be unreasonable for the law to forbid a thing to be done and then to mulct the party in damages in an assessment of interest for not doing it. The law works no such injustice, and is chargeable with no such absurdity. The whole doctrine of interest is based upon the idea that it is a profit or premium properly payable for the use of money with which one man has of the money of another. So there can be no allowance of interest on a fund in the hands of the court or its receiver, or that is being brought in by the receiver, unless the fund produces interest.

Gaston v. Shunk Plow Co., 161 Ga. at 304, 130 S.E. at 588. (Citations omitted.) See also <u>Bank of China v. Wells Fargo Bank and Union Trust, 209 F.2d 467, 475-76 (9th Cir.1953)</u> (money deposited in court, pursuant to court order requiring court permission to pay out, does not ordinarily bear interest for recipient).

[19] We believe the circumstances of this case are outside the general rule. The injunction [FN5] did not prohibit American Savings from settling claims, it only prevented American Savings from initiating settlement discussions. The injunction also did not require American Savings to segregate the rescission Instead, American Savings could use its funds for reasonably necessary operating expenses and make other disbursements and investments with the approval of the agent of the court. Savings had the use of the money obtained by its fraudulent scheme for many years. Under the conditions of this injunction, American Savings should not escape payment for the use of the investors funds.

FN5. We assume that the portion of the injunction at issue is the one enjoining American Savings from "[m]aking any statement or taking any actions designed to influence stockholders as to the value of their stock or as to their choice of relief under any court ordered reorganization."

[20] The final argument over prejudgment interest is whether the investors were required to make demands for payment to be entitled to prejudgment interest.

See *559**1142Fairway Builders v. Malouf Towers Rental Co., 124 Ariz, 242, 264-65, 603 P.2d 513, 535-36 (App.1979). We disagree with American Savings that the investors had to make demands for payment on their claims to earn prejudgment interest. Investors were unaware of the nature of American Savings's scheme until the complaint was filed and the trial exposed the fraud. Prior to notice of the fraud, the investors had no grounds upon which to demand payment. The need for each investor to bring suit on his or her own against American Savings was obviated by the state's suit, which sought relief for the investors. Most importantly, American Savings was protected from suit by the September 1977 injunction, which prohibited investors from filing suit unless they first obtained court permission to do so. Thus, if the investors had demanded payment, their means of seeking adjudication by the court could have been barred by the exercise of the trial court's discretion. Court control over the filing of additional suits worked to the advantage of American Savings and should not be used against the investors' interests.

[21] American Savings protests the award of prejudgment interest on the total premiums before the premiums be offset by the mortality expenses incurred. We agree with the trial court. A.R.S. § 44-2001 states that a purchaser may recover "the consideration paid for the securities, with interest thereon, taxable court costs and reasonable attorneys' fees, less the amount of any income received by dividend or otherwise from ownership of the securities...." The order of these phrases is not without significance. Although the general rule may be that prejudgment interest is only to be paid on the net amount, see, e.g., Homes and Son Construction Co. v. Bolo Corp., 22 Ariz.App. 303, 526 P.2d 1258 (1974), we cannot ignore the special wording of A.R.S. § 44-2001, the statutorily enacted remedy for The award of prejudgment voidable securities. interest by the trial court is affirmed.

CONCLUSION

American Savings is not entitled to a modification of the plan of reorganization or an evidentiary hearing prior to rescission on facts surrounding each individual's investment. The trial court erred in denying the rescission option to all investors by improperly applying the statute of limitations. In addition, the investors' payment or nonpayment of premiums does not affect their option to rescind. The plan's disallowance of all expenses other than mortality as fair costs of insurance is not clearly erroneous, and the award of prejudgment interest was

733 P.2d 1131 152 Ariz. 548, 733 P.2d 1131, Blue Sky L. Rep. P 72,454 (Cite as: 152 Ariz. 548, 733 P.2d 1131)

well within the trial court's discretion.

Because American Savings is not the prevailing party on appeal, its request for attorney's fees on appeal and in the lower court is denied.

Affirmed in part, reversed in part and remanded with directions.

BROOKS and OGG, JJ., concur.

NOTE: The Honorable JACK L. OGG, a retired judge of a court of record, was authorized to participate in this matter by the Chief Justice of the Arizona Supreme Court, pursuant to <u>Ariz. Const. art. V1, § 20</u>.

152 Ariz. 548, 733 P.2d 1131, Blue Sky L. Rep. P 72,454

END OF DOCUMENT

Exhibit

"2"

ROSHRA DEWULF & PATTEN

ROSHKA DEWULF & PATTEN, PLC ATTORNEYS AT LAW ONE ARIZONA CENTER 400 EAST VAN BUREN STREET SUITE 800 PHOENIX, ARIZONA 85004 TELEPHONE NO 602-256-6100 FACSIMILE 602-256-6800

April 9, 2014

By First Class Mail and Email

Steven J. Womack, Esq.
Enforcement Attorney
Securities Division
Arizona Corporation Commission
1300 West Washington Street, Third Floor
Phoenix, Arizona 85007

Re: In the matter of Concordia Financing Company, Ltd, et al. Docket No. S-20906A-14-0063

Dear Mr. Womack:

This letter responds to your letter dated April 8, 2014. Your letter alleges that I violated Rule 11(a) of the Arizona Rules of Civil Procedure by failing to cite *Trimble v. American Savings Life Insurance Co.*, 152 Ariz. 548, 733 P.2d 1131 (Ct. App. 1986) in the Motion to Dismiss and Answer ("Motion") filed April 4, 2014. Your letter also threatens sanctions, unless we "either withdraw the statute of limitations arguments or explain why *Trimble* is inapposite...."

Let me start with a point of agreement. I agree that Rule 11 of Arizona Rules of Civil Procedure applies to Commission proceedings. I am glad that the Division recognizes that the Rules of Civil Procedure apply, at least in part, to Securities dockets pending before the Commission, as this has been a point of some dispute in the past.

Where I strongly disagree, however, is the allegation that I violated Rule 11(a). Rule 11(a) provides, in part, that "The signature of an attorney or party constitutes a certificate by the signer that the signer has read the pleading, motion or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation." (emphasis added).

The Motion fully complies with Rule 11(a), and accordingly, our firm declines to withdraw it. Further, your April 8, 2014 letter assumes that we did not review *Trimble*. To the contrary, we did review *Trimble* and concluded that it is distinguishable and not controlling in this matter, and therefore, we did not cite it in our Motion. The Division, of course, is welcome to argue in its Response to our Motion that *Trimble* is controlling, or that it should be extended to securities enforcement actions. We anticipate that this is an issue that will eventually be decided

ROSHKA DEWULF & PATTEN

Steven J. Womack, Esq. April 9, 2014 Page 2

by the Arizona Court of Appeals, and perhaps, the Arizona Supreme Court. Our reasoning for why we do not believe *Trimble* controls is below.

Trimble was a court case brought by the State of Arizona (at the request of the Directors of Insurance and Securities) to place an insurance company into receivership. The Trimble opinion resolved an appeal against the reorganization plan approved by the Superior Court in that receivership case. In construing the Statute of Limitations expressed in A.R.S. § 44-2004, the Court of Appeals noted "proper focus must be on the legislative intent of insurance rehabilitation statutes." Trimble, 152 Ariz. at 555, 733 P.2d at 1138. Likewise, the Court stated "[w]e emphasize the importance of the insurance rehabilitation statutes in this matter." Trimble, 152 Ariz. at 556, 733 P.2d at 1139.

With this background in mind, the *Trimble* case is not controlling in this docket, for five reasons.

First, the type of relief sought in this case is very different from *Trimble*. This is an administrative enforcement proceeding where the Securities Division seeks administrative penalties and other relief. Seeking receivership relief is very different than the administrative penalties sought in this enforcement action. In discussing the scope of the federal Statute of Limitations that applies to S.E.C. administrative enforcement actions, the D.C. Circuit has held that the Statute applies to administrative actions which "clearly resemble punishment in the ordinary sense of the word" *Johnson v. S.E.C.*, 87 F.3d 484, 488 (D.C. Cir. 1996). Here, the Division's Notice seeks penalties against the Respondents, to punish them for alleged violations of the Arizona Securities Act. Thus, this case is much more like the securities enforcement proceeding at issue in *Johnson* than the receivership proceeding at issue in *Trimble*.

Second, *Trimble* is likely limited to receivership cases. Our research reflects that only one Arizona case discusses the Statute of Limitations portion of *Trimble*. See In re Diamond Benefits Life Ins. Co., 184 Ariz. 94, 98, 907 P.2d 63, 67 (1995). Diamond Benefits extended the exception from the Statute of Limitations recognized in *Trimble* for insurance receiverships involving rehabilitation pursuant to A.R.S. § 20-620(A) to also include insurance receiverships involving liquidation pursuant to A.R.S. § 20-621(A). Diamond Benefits, in turn, has been cited in various other receivership cases. See Warfield v. Alaniz, 453 F. Supp. 2d 1118, 1131 (D. Ariz. 2006)(refusing to exempt receiver from statute of repose related to fraudulent transfers) aff'd, 569 F.3d 1015 (9th Cir. 2009); Warfield v. Gardner, 346 F. Supp. 2d 1033, 1047 (D. Ariz. 2004)(extending Diamond Benefits to receiver pursuing conversion claim). Thus, Trimble and Diamond Benefits are likely limited to receivership cases.

Third, the "insurance rehabilitation statutes" were a major basis of the decision in *Trimble*, but are not relevant to this case. In short, this case has nothing to do with insurance rehabilitation.

Fourth, *Trimble* is also notable for its extensive discussion of federal cases in construing various provisions of the Arizona Securities Act. *Trimble* cites at least eight federal securities cases. That is consistent with our argument that A.R.S. § 44-2004 should be construed in light of federal securities law, and that the Commission should not "be able to tread where the SEC cannot." (Motion, pages 4-7 generally, quoted phrase at page 4, lines 8-9). *Trimble*'s policy of

ROSHKA DEWULF & PATTEN

Steven J. Womack, Esq. April 9, 2014 Page 3

looking to federal securities law to guide interpretation of the Arizona Securities Act has been confirmed and strengthened by the recent Arizona Supreme Court case of Sell v. Gama, 231 Ariz. 323, 327, 295 P.3d 421, 425 (2013). As we discuss in the Motion, developments in federal securities law that occurred after Trimble support applying a Statute of Limitations to securities enforcement actions. Such developments are highly persuasive in interpreting the Arizona Securities Act, under the policy of looking to federal securities law articulated in Sell, and indeed, in Trimble.

Fifth, the recent United States Supreme Court opinion Gabelli v. S.E.C., 133 S. Ct. 1216, 1223 (2013) persuasively explains why Statutes of Limitations should apply in securities enforcement cases. For example, the Court noted that a rule that "extended the limitations period to many decades" must be rejected because it would be "beyond any limit that Congress could have contemplated" and "would have thwarted the basic objective of repose underlying the very notion of a limitations period" Id., quoting Rotella v. Wood, 528 U.S. 549, 554 (2000). The Court also explained that Statutes of Limitations "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared." Id.,133 S.Ct. at 1221, quoting Railroad Telegraphers v. Railway Express Agency, Inc., 321 U.S. 342, 348–349 (1944). Those concerns are at the forefront of this case, but would have been of little relevance in a receivership case like Trimble.

In short, our Statute of Limitations argument "is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law" within the meaning of Rule 11(a). The Division is free to cite to *Trimble* in its Response to the Motion to Dismiss, and we will respond to any such argument in due course, including elevating this issue to the courts if necessary. But simply because the Division disagrees with our conclusion that *Trimble* is not controlling in this administrative enforcement proceeding does not mean that we have violated Rule 11(a) or that sanctions are warranted.

Very truly yours,

ROSHKA, DeWULF & PATTEN, PLC

Timuly Dall Timothy J. Sabo For the firm

TJS/da

cc: Alan S. Baskin, Esq.

Exhibit

"3"

Affidavit of David John Wanzek - Page 1

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4.	I moved t	to Florida	in A	April o	of 2010.	Since that	time,	Florida	has	been	my
permanent residence.											

- 5. I hold a Florida driver's license. A copy of my driver's license is attached as Exhibit A.
- 6. I am registered to vote in Florida and I voted in the last presidential election in
- I opened an accounting practice in Florida in 2010. I was also partners in a bicycle
- My wife and I have owned a home in Florida since 2008. Florida became our
- I have CPA license from the Florida Board of Accountancy, part of Florida Department of Business and Professional Regulation. A copy of my Florida CPA license is
- My minor children live with me in Florida. They attended school in Florida from August 2010 through March 2013. They are now home-schooled in Florida. One of my sons (age 16) has a Florida driver's license, and another son (age 15) has a Florida learner's permit.
- I intend to remain in Florida as my permanent residence. I do not intend to resume
- My wife, our children and I have seen Florida doctors, dentists and orthodontists
- I travel to Arizona for business regularly. However, I spend a clear majority of my
- My wife and I own a residential property in Lake Havasu City, Arizona. I use this property as a secondary residence, and I stay there when visiting Lake Havasu City for business. Legal title to this property is held by a trustee under a deed of trust on behalf of the lender, Wells Fargo Bank, N.A. We would prefer to sell the property, but it is difficult to do so with the property

property being "underwater", that is to say, we owe more on this property than it is worth; we have no equity in this property.

DATED this 15 day of May, 2014

DAVID JOHN WANZEK

SUBSCRIBED AND SWORN to before me this day of May, 2014 by David John Wanzek

Symboly My Mactry Notary Public

My commission expires:

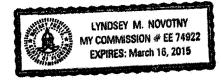


Exhibit A to Affidavit of David John Wanzek



Exhibit B to Affidavit of David John Wanzek



STATE OF FLORIDA DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION

BOARD OF ACCOUNTANCY 240 NW 76TH DRIVE, SUITE A GAINESVILLE FL 32607

(850) 487-1395

WANZEK, DAVID J 3956 TOWN CENTER BLVD STE 560 ORLANDAO FL 32837

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STATE OF FLORIDA DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION

AC45060

*ISSUED: 11/12/2013

CERTIFIED PUBLIC ACCOUNTANT
WANZEK, DAVID

IS LICENSED under the provisions of Ch.473 FS. Expiration date: DEC 31, 2015 L1311120000886



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DETACH HERE

RICK SCOTT, GOVERNOR

STATE OF FLORIDA

KEN LAWSON, SECRETARY

DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION BOARD OF ACCOUNTANCY

LICENSE NUMBER

AC45060

The CERTIFIED PUBLIC ACCOUNTANT Named below IS LICENSED Under the provisions of Chapter 473 FS. Expiration date: DEC 31, 2015



WANZEK, DAVID J 3956 TOWN CENTER BLVD STE 560 ORLANDAO EL 32837



ISSUED: 11/12/2013 SEQ # L1311120000866 DISPLAY AS REQUIRED BY LAW